Overseas opportunities and Challenges

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The economist John Dunning has identified 4 primary reasons for foreign investments:

- **Market seeking:** Go overseas to find new buyers for goods and services. Many companies look to international markets for growth. Introducing new products internationally can expand a company's customer base, sales and revenue.

- **Resource seeking:** Availability of natural resources like Oil, Minerals etc. that are difficult to obtain in their home markets.

- **Strategic asset seeking:** Firms may seek to invest in other companies abroad to help build strategic assets, such as distribution networks or new technology.

- **Efficiency seeking:**
  - Cheaper inputs of production (land, labour, capital, and materials)
  - Favourable trade agreements
  - Tax rates and regulations: Taxes and regulations are a primary reason to locate a company in countries that have favorable business tax laws, such as in the Caribbean, Swiss, Singapore, Mauritius etc.
Need for Overseas Investments

Other important reasons for foreign investments:

- **Cost sharing and Broad basing:** Where heavy investments are needed for Product innovation such as for Pharma, High end technology. The minimum size of market needed to support technological development in certain industries is now larger than the largest national market.

- **Risk mitigation and Diversification:** Companies go international to diversify. Selling products and services in multiple countries reduces the company's exposure to possible economic and political instability in a single country.

- **Local Expertise:** Some countries are famous for a particular area of expertise, such as Italian silk manufacturing and Indian technical support. Companies go overseas or outsource jobs to take advantage of those skills.

- **Ideas and Innovation:** Companies go international to broaden their work force and obtain new ideas. A work force comprised of different backgrounds and cultural differences can bring fresh ideas and concepts to help a company grow. IBM actively recruits individuals from diverse backgrounds because it believes it's a competitive advantage that drives innovation and benefits customers.
Need for Overseas Investments

Sometimes there is no choice:

- Very High Import Tariff or ban on imports: If you have to sell Automobiles in India, you better invest and set up manufacturing facilities here, the import of cars is unviable.

- Ban on export of resources or export duties: Minimum value addition conditions are placed on export of products which sometimes calls for major investments.

- Local Address: In Countries like USA, the customers want to deal with only a company having its presence in USA.

- De risk: Subsidiary companies are set up overseas and local operations are routed through the subsidiary to limit the damage and avoid the extension of liabilities to the parent company.
Tax rates influence the investment destinations

- One major way Corporates avoid taxes is by parking their profits overseas legitimately. Companies searching out tax havens is nothing new: in the 80s and 90s there was an exodus to Bermuda and the Cayman Islands, where there are no taxes at all.
- Many large US companies - offshore drilling contractors Noble Corp and Transocean, energy-focused engineering group Foster Wheeler and oilfield services company Weatherfield International have shifted or in the process of shifting domicile to Switzerland.” For the canton (state) of Zug, some 30 miles from Zurich, the moves have been called a “virtual energy boom.”
- Zug's main selling point isn't a view of the Alps: but lower taxes of 15/16 percent. The population of the town of Zug is 26,000; the number of companies in the area is 30,000 and growing. By renouncing their American citizenship, Transocean saved about $2 billion in taxes
- US government is in knots over ways to lower the federal budget deficit. However - over $60 billion a year – of tax money is lost due to American corporations headquartered elsewhere.
Benefits of Overseas Investment

Benefits for Host Countries
- Create jobs and help generate growth of the Economy through multiplier Effect
- bring expertise and technology that the host country does not have
- train locally hired staff, which has long-term benefits for the host country
- Increased competitiveness in domestic industry

Benefits for Home Countries and Companies
- Foreign companies' main aim is to make profit and, in most cases, take it back to their home country. Foreign companies benefit by increasing their market reach or lowering production costs by hiring cheap labour or using cheap raw materials in host countries.
What to look for in an overseas investment

- Good Business & Growth prospects
- Quality Resources
- Helpful and Business Friendly State
  - Regulatory
  - Taxation
- 100% ownership
- Good location (raw material and customers)
- Excellent purchase price
- Shorter payback period
- Quick deal
- Viable EXIT strategy / listing – encashing the investment on attaining maturity
In case of a Joint Venture...

- Financially strong, technically competent JV Partner
- Majority control
- Experienced management and employees to be assigned by JV Partner
- Attractive returns for both the JV partners

JV Partner- What to look for

- JV Partner who is also Reliable, committed for long term relationship and resourceful (wishful thinking?)
- A Great Long Term JV Partner Could Lead To Many Other Investment Opportunities In The Future.
- Has the JV Partner completed the basic feasibility studies
- Can the JV Partner arrange for Debt if required?

(Regular due diligence process should be carried out the details are not discussed here)

My idea of an agreeable person is a person who agrees with me.
- Benjamin Disraeli
Challenges

- **Protectionism**: Countries may impose some measures with the intention of protecting domestic industries from international competition and promoting their economic development.
- **Domestic Content**: foreign investors to purchase a certain percentage of intermediate goods from the host country.
- **Value Addition**: May insist that only value added materials only could be exported.
- **Expropriation**: The seizure of foreign assets by governments due to Changes in governments in developing countries, or sometimes just changes in policies, have led to government takeovers of foreign assets. In the past, these expropriations have nationalized key industries (e.g. oil, electric power, mines, or telecommunications), often providing little or no compensation to the original owner.
- **Limitations on transfer of funds**: during periods of economic crisis, foreign investors may wish to withdraw their assets, and have often found that foreign governments have imposed rules blocking their ability to do so.
- **Dispute settlement**: Sometimes the local Courts do not favour external investors- difficulty in enforcing judgements even when they are in favour of overseas investor.
Challenges

Diversity and change
- Geographic & Regional diversity
- Political and Economic diversity

Cultural diversity – (national culture / corporate culture)
- The business environment
- Discrimination – Racial Discrimination
- Education and training
- Work ethic
- Corruption
- Etiquette and behavior
- (Etiquette may appear trivial—whether to use first or last names, what to wear, how to behave at lunch or at meetings. However, if you get stuck on this superficial level of interaction it is hard to penetrate to a more satisfying level of understanding and cooperation)
Challenges

When you want to sell your products in developed country like USA

BMW of North America, Inc. v. Gore

- **Facts**: The plaintiff, Dr. Ira Gore, bought a new BMW, and later discovered that the vehicle had been repainted before he bought it. Defendant BMW revealed that their policy was to sell cars damaged (during transportation) as new if the damage could be fixed for less than 3% of the cost of the car.

- Dr. Gore sued, and an Alabama jury awarded $4,000 in compensatory damages (lost value of the car) and $4 million in punitive damages, which was later reduced to $2 million by the Alabama Supreme Court. The Supreme Court found that BMW’s conduct was not particularly reprehensible (no reckless disregard for health or safety, nor even evidence of bad faith)
Challenges

Change in Host Countries attitude and Consequent regulatory Changes

- While the host country is underdeveloped, it encourages foreign investment for developing its Economy and lays down a red carpet with several incentives like allotment of resources, concessional tariffs and tax holidays.

- The same country when it reaches a certain level of development, resents the Foreign investors making too much of money. The efficiency, the superior technology and rewards reaped due to its risk taking abilities are now looked at as profiteering through exploitation. The concessions are withdrawn and new rules are brought in to tax the profits.

If the government is big enough to give you everything you want, it is big enough to take away everything you have.
- Gerald R. Ford
Case Study Indonesia

Importance of Coal Imports from Indonesia:

- Indonesia is a major supplier of Coal to India and China.
- Large investments made by major power producers like Tata Power, Reliance Power, Adani Power and Lanco. India Currently runs around 9000 MW of capacity based on Indonesian Coal and another 10000 MW capacity is under execution.
- The investments were made with an assumption that coal would cost about US$ 40 – 50 per MT, cost plus basis. The power companies have set up power projects investing huge amounts, signed agreements with Electricity boards to supply power based on the coal cost as above.

Under Indonesia’s New Energy Security Policy, the Government has introduced new regulations for

- domestic processing and refining, coal upgrading
- benchmark pricing
- domestic market obligation
- compulsory Dilution in the holdings of foreign investor
Case Study Indonesia

Regulations regarding domestic processing

- Draft Value Added Regulation envisages that, starting in January 2014, lease holders are obliged to carry out processing and refining of mining products in Indonesia and prohibited from exporting mining products before local processing and refining has taken place.

- A “minimum” level of value added upgrading required before export is to be determined, for each mining product and it would be reviewed and adjusted, once every two years.

- Indonesia plans to impose a 25% export tax on coal and base metals this year, jumping to 50% in 2013; It plans to ban exports of unprocessed copper, gold, silver, nickel, tin, bauxite and zinc by 2014.

Bench Mark Pricing

As part of the Government’s efforts to stop transfer pricing abuses which have resulted in the loss of Taxes and royalties, Indonesian Government has stipulated that mineral and coal producers are obliged to sell minerals and coal based on a regulated benchmark price, including to any affiliate/holding company. The current bench mark price is about US 120, as compared to USD 40-50, based on cost plus.
Case Study Indonesia

- **Domestic market obligation**: From 2010, the Ministry of Energy and Mineral Resources issued a new regulation on prioritising mineral and coal resources for domestic usage. The Regulation requires coal and mineral producing companies to allocate a certain minimum percentage of its total production to the domestic market. The proportion for the domestic market obligation (DMO) will be equal to the estimate of annual demand proposed by potential domestic buyers a year earlier.

- **Compulsory Divestment**: Commencing after the end of the 6th year of Production, divest at least 20%, which would gradually go up to 51% at the end of year 10, with the central government, provincial governments and regional governments having a priority right to take up the divested shares. As the shareholdings of the local parties cannot be diluted, the increased divestiture requirement effectively means that the local parties will receive a 51% “free carried interest”. In other words, the local parties cannot be effectively required to contribute anything to the future costs of the project in the event of expansion or further development.

Envy was just the tax you paid on success.

- *David Nicholls*
Case Study Australia

"The Fraser Island Case"

- This 1976 Australian case involved two mining companies, one Australian and the other American, which for many years had been mining rutile from Fraser Island, an island just off the coastline of the Australian State of Queensland. There was no market for rutile in Australia and the two companies depended on shipping the rutile to export markets in order to make any profit.

- Due to Environmental concerns the Federal Government opposed to continuation of the mining. It therefore made an administrative decision to withhold further export permits. (the control of exports being an exclusive federal power).

- The two companies went to Court, argued that environmental considerations could not, as a matter of administrative law, be properly taken into account by the Federal Government in deciding whether to grant export permits. However, the High Court of Australia (Australia's Supreme Court) unanimously rejected this argument and ruled in favour of the Federal Government.

For every action there is an equal and opposite government program.
- Bob Wells
Case Study Australia

- Nothing had been confiscated or taken away from the two companies: However, the administrative decision had blocked their access to export markets and its effect was to destroy the value of their investment.

- Under Australian law, an act of expropriation would give rise to a legal claim for compensation. However, the court held that this was not a case of expropriation (although ultimately the Federal Government offered compensation to the investors, which they accepted).

- There were two flaws in the original investment decision:
  - (i) the investors underestimated the risk of future changes in environmental standards; and
  - (ii) the investors did not foresee that there would be a conflict between the State and federal governments in Australia.

- Although the mining investment was made in a country with a well-established legal system, noted for its reputation of certainty and stability, the value of the investment was destroyed by an administrative decision.

Australia has passed laws for a new 30 per cent tax on iron ore and coal mine profits, in March 2012. The tax will affect about 30 companies, including global miners BHP Billiton, Rio Tinto and Xstrata, and aims to raise about $11.2bn (A$10.6 Billion) in its first three years.
US regulations pose different problem

- Higher Visa costs and refusal of Visas causes Problems for Indian Software companies who have set up businesses there.
- L&T Infotech has been accused by a former employee, Nanda Pai, in a US court of violation of immigration laws, fraud, and fabrication of documents. She is seeking to be part of a gender discrimination class action suit filed by another employee, Deepa Shanbhag, in a New Jersey court. Pai also said she was made a scapegoat in the immigration fraud and her signature was forged in some documents. The original class action suit, which Pai seeks to join, asks for damages of not less than $100 million.
- Similar Case filed against Infosys by one of its employees, Jack Palmer with allegations of visa misuse and fraud.
- Class action lawsuits: A US court in California has granted class action status to a lawsuit against TCS which according to two former employees allegedly refused to return tax refunds besides not paying promised wages.
The importance of utmost probity

- Overseas Investors need always to be on guard against becoming involved (even indirectly) in corruption and any other activity which might constitute criminal conduct or give rise to illegality in the host country. Criminal conduct in many countries is not limited to corruption. It may include:
  - breach of labour laws;
  - illegal import or export of goods or currency;
  - tax evasion;
  - breach of environmental laws;
  - breach of consumer protection laws.
- Foreign businessmen face the additional personal risk that they may be put under house arrest or have their exit visas revoked.
- Most importantly, a contract obtained by corrupt practices under most legal systems is not only illegal but unenforceable.

Indian Example: SC cancels 122 telecom licences following 2G scam

- Uninor, a joint venture between Norway's Telenor and India's Unitech, saw all its 22 telecom licences cancelled following the Supreme Court verdict. Telenor, had bought 67.25 per cent stake in the joint venture with Unitech for about $1.2 billion and operated under the Uninor brand.
Tata Daewoo Success Story

- In 2004, employees at Daewoo Commercial Vehicle heard the news that they would have a new owner Tata Motors, after months of uncertainty sparked by the bankruptcy of its parent company Daewoo Motor Co.
- Tata was something they had never heard about before. "A lesser known company tries to buy us to snatch our advanced technology." "It is out of the question to sell our company to India, they are inferior to us."
- The management, however, went ahead to sell the truck maker to Tata Motors because there was no other choice left.
- Tata Daewoo, the new company was back on track to roll to victory. Within four years exports jumped 5 times, revenues more than doubled and operating profit grew more than 8 times
- Tata Daewoo is the only one showing a stable and steady growth among the three business arms that Daewoo Motor Co. sold. Tata Daewoo workers who knew little about the Indian company are grateful for the acquisition.
- Tata Motors never behaved as if it were an occupation force. It appointed a native Korean as CEO and it respected the Korean business style and corporate culture, while slowly integrating its strength of trust and ethical management into the whole organization.
- Tata Business Excellence Model. It is different from the Western model that usually focuses only on efficiency. Tata's model is not only about profit-seeking, but it considers the growth of both the company and the community.
Overseas Acquisitions

- Acquisitions is one of the three major routes for business expansion, the other two being organic growth and strategic alliances.

- L. N. Mittal’s success story is legendary. The family steel business was handed over to him in 1970s from which he branched out his own business in 1994. In less than a decade, L. N. Mittal has spectacularly expanded the company from a wire rod manufacturer in Indonesia to the largest steel producer in the world, largely through an acquisitive strategy. He bought steel mills for a cheap price in Eastern Europe and therein commenced his journey to be a billionaire.

- Why M&As fail?
  - A merger may often have more to do with glory-seeking than business strategy. The executive ego, which is boosted by buying the competition, is a major force in M&A.
  - Mergers are often attempt to imitate: somebody else has done a big merger, which prompts other top executives to follow suit.
  - A reasonable purchase price is a must, but usually the acquisitions are done during boom time and the acquisition prices are inflated.
It is all about Valuation

- As usual, the important determinant of an investment decision is “THE PRICE” at which the acquisition took place and hence Valuation is the key.

- Some Errors would be very costly:
  - Judgement of Country risk and Political Risks
  - Exaggerated Optimism/ Pessimism when forecasting future cash flows
  - Wrong assessment of synergy benefits
  - Effect of Change in Economic conditions
  - Confusing strategic value with fair market value

Many an optimist has become rich by buying out a pessimist.
- Robert G. Allen
Chinese Overseas Investments

- Flush with more than $2 trillion in foreign exchange reserves, China has directed its state firms to scour the globe for opportunities.
- Chinese have significant investments in the agribusiness, hydropower and mining industries in the Southeast Asia's Mekong region (Cambodia, Laos and Vietnam).
- China’s economic rise and consequent demand for a reliable and steady supply of inexpensive natural resources have led to a rapid increase in Chinese foreign direct investment stretching all the way to Africa and Latin America. Chinese firms have been rapidly acquiring equity stakes in natural resource companies, extending low-cost loans to mining and oil firms, and writing long-term off-take agreements.
- China investment Corporation (CIC) has been one of the most prominent of the sovereign wealth funds. Established in 2007 with $200 billion, the fund drew widespread attention with early, high-profile investments in Blackstone and Morgan Stanley. CIC's latest focus is on natural resources.
Conclusion

- Overseas Investments are necessary (evil) in the Globalised World. The Whole world is the target market. Economies of Scale demand that Companies set up Capacities at Globally comparable and competitive scale.
- All resources (Men, Material and people) are not available in one location and the businesses have to set up cross border establishments if they wish to excel.
- While there are risks, there are rewards too.
- Best business leaders are able to balance risk and rewards and come out triumphant.

Great deeds are usually wrought at great risks.
- *Herodotus (484 BC - 430 BC)*
Thank You